



CHEMONICS INTERNATIONAL INC.

Electronic Document Submission Title Page

Contract No.: 278-C-00-02-00210-00

Contractor Name: Chemonics International, Inc.

USAID Cognizant Technical Office: Office of Economic Opportunities
USAID Jordan

Date of Product/Report: July 13, 2004

Product/Document Title: Review and Assessment of Legal Issues Related to
Asset Backed Securities

Author's Name: International Business Legal Associates (ABLAW)

Activity Title and Number: Achievement of Market-Friendly Initiatives and
Results Program (AMIR 2.0 Program)

D/Local Legal Review and Assessment,
FMD Component, Work Plan No. 636.05

Name and Version of Application
Software Used to Create the File: MS Word 2002

Format of Graphic and/or Image File: N/A

Other Information: N/A

Review and Assessment of Legal Issues Related to Asset Backed Securities

Final Report

Contract No.:	278-C-00-02-00210-00
Contractor Name:	Chemonics International, Inc.
USAID Cognizant Technical Office:	Office of Economic Opportunities USAID/Jordan
Date of Report:	July 13, 2004
Document Title:	Review and Assessment of Legal Issues Related to Asset Backed Securities Final Report
Author's Name:	International Business Legal Associates (IBLAW)
Activity Title and Number:	Achievement of Market-Friendly Initiatives and Results Program (AMIR 2.0 Program) D/Local Legal Review and Assessment, FMD Component, Work Plan No. 636.05

This report was prepared by International Business Legal Associates (IBLAW), in collaboration with Chemonics International Inc., prime contractor to the U.S. Agency for International Development for the AMIR Program in Jordan

Data Page

Name of Component: Financial Markets Development

Author: International Business Legal Associates (IBLAW)

Practice Area: Financial Sector

Service Offering: Housing Finance

List of Key Words Contained in Report:

Asset Backed Securities, Securities Law, Mortgage, Pledge, Commercial Debt, Capital Markets, Corporate Bonds, Securitization, Fluctuation of Assets, Bonds Owner's Assembly, Issue Trustee, Documentation, Jordan Securities Commission, Land Registry Department

Abstract

The report provides a legal assessment under Jordanian law of the possibility of mortgaging assets as security for negotiable bonds issued in favor of a pool of bondholders. Enabling such collateralization is a critical element for implementing recommendations to develop a mortgage backed bond market, and eventually, more broadly as a basis for securitization of assets.

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Executive Summary

This report is a deliverable under scope no 636.05 Asset Backed Securities Law entitled D/Local Legal Review.

The report provides a legal assessment under Jordanian law of the possibility of mortgaging assets as security for negotiable bonds issued in favor of a pool of bondholders. Enabling such collateralization is a critical element for implementing recommendations to develop a mortgage backed bond market, and eventually, more broadly as a basis for securitization of assets.

The findings of this report are based on analysis of collateralization transactions, best practices and a comprehensive review and assessment of the relevant legislation to identify pertinent enabling provisions or legal obstacles. In defining the nature of such transactions, we have consulted with AMIR expert Mr. Strauss, and industry practitioners such as Atlas, Jordinvest and Export & Import Bank.

Summarily, the report argues that the legal requirements for documenting the mortgage of assets and the legal enforceability of trading assets guaranteed bonds need to be reviewed. Therefore, there are several legal obstacles that hinder the effective collateralization of assets as security for negotiable corporate bonds held by a pool of bondholders. Jordanian laws provide an adequate general basis for mortgaging assets as security for bonds; however, the problem arises where such bonds are negotiable.

The legal problems are substantive in part and procedural in the other part. The rules governing mortgage and their transfer under Jordanian legislation have not been enacted with the specific needs of the securities market in mind. In particular, the legal rule pertaining to the transferability of the mortgage and the documentation procedures stipulated in current laws are impractical and constitute a serious obstacle and impediment to the requirements of negotiability within the Capital market. Moreover, beyond the collateralization of assets to secure bonds, the current legislation does not provide a clear regulatory framework for the securitization of assets.

The report argues that effective transfer of a mortgage in the context of capital markets requires enabling legal amendments, and recommends specific legal framework for accommodating such amendments. However, enabling and regulating securitization of assets generally would require the enactment of a special governing legislation. Such would provide solid foundation for this critical element of modern capital markets, and would be consistent with international best practices and developments in this arena.

Section One: Introduction:

Corporate bonds are negotiable securities issued by corporation and can be offered for subscription in accordance with the provisions of the Jordanian companies law and Securities Law in order to obtain a loan and shall be registered in the names of their owners. The selling of corporate bonds shall be documented in the issuing Company's registers or with the authority, which keeps such registers. These corporate bonds are negotiable in the markets as stipulated in the Securities Law in force. If corporate bonds are guaranteed by assets, then the said assets must be held as a security for the loan in accordance with the legislations in force, and such guarantees must be documented.

Trading in bonds in the market means the transfer of the ownership rights. Such transfer is affected by registration of the sale transaction at the company's register. In the case where the bonds are guaranteed by a mortgage, a question regarding the transferability of the mortgage is raised. In addition, the documentation procedures for mortgages raise another question regarding the organization and registration of the mortgage in one hand and the documentation of the transfer in the other hand. Under these issues, the specific conditions of the assets to be subject to the mortgage will also require consideration, especially with regards to the changing value of the assets. On the other hand the companies law provides for a bondholders Assembly and an Issue Trustee for that Assembly. The examination of the assembly and the issue trustee's legal capacity and powers shall be also subject to our assessment.

The following are the related legislations i) The Companies Law No. 22 of 1997 and its amendments, ii) The Securities Law No. 76 of 2002, iii) The Civil code No. 43 of 1976, iv) The Commercial Code No. 12 of 1966, v) The Law of holding immovable properties as security for debt No. 46 of 1953 and its amendments, vi) The Instruction on Mortgage, its Transfer and Dismortgage of 2001, vii) The Law of the Notary Public No. 11 of 1952 and its amendments.

In order to assess the legal frame work for holding assets as securities for bonds we will illustrate the available kinds of mortgages in Section two; the documentation requirements in Section three; the Fluctuation of Assets in Section Four; Bondholder's Assembly and Issue Trustee in Section Five; in Section Six we will assess the legal issues; in Section seven a discussion regarding how to overcome the obstacles will be presented; and finally in Section Eight we provide our recommendations.

Section Two: Kinds of mortgages:

Article (122) of the Companies law provides that: “if corporate bonds are guaranteed by movable or immovable property or by other in-kind assets or any other guarantees or collateral, the said properties and assets must be held as a security for the loan in accordance with the legislations in force, and the mortgage, guarantee, or collateral must be documented before handing over the subscription proceeds in the corporate bonds to the Company.”

Under Jordanian Laws, collateralization of the mentioned assets is dealt with in civil code and commercial code as follows:

a. The civil code provides the following articles:

I. Security Mortgage:

Section (1322) The security mortgage is a contract by virtue of which the creditor gains a real right on a specified immovable property for the satisfaction of his debt by virtue of which he has priority over ordinary creditors and creditors who are next to him in degree for the satisfaction of his right from the price of that property irrespective of who owns it.

Section (1333) The mortgage shall not be subject to division and every part of the mortgaged immovable property shall secure all the debt and every part of the debt shall be secured by the mortgaged immovable property.

Section (1334) The provisions relating to security mortgage shall be applicable to the movable property, which is subject to registration by virtue of the laws relating to it like the car or ship.

Section (1346) The effect of the security mortgage shall be limited to the sum specified in the mortgage deed and recorded in the Land Registry Department unless the law or the agreement otherwise provides.

II. Possessive mortgage:

Section (1372) The possessive mortgage is the detention of property in the possession of the creditor or a competent person as security for a right, which can be totally or partially levied from him with priority over the remaining creditors.

Section (1373) In order to be capable of being put under possessive mortgage the property shall be capable of delivery and sale at the time of mortgage.

Section (1382) The provisions of Section (1333) of this Code precluding the division of property mortgaged as security for a debt shall be applicable to the possessive mortgage and it shall all remain as security for all or part of the debt.

Section (1416)

1. The debtor of a mortgaged debt shall pay the debt simultaneously to the mortgagor and mortgagee if it falls due before the maturity date of the debt secured by the mortgage.
2. And the mortgagor and mortgagee may agree on depositing what the debtor pays with a competent person until the mortgaged debt is mature and the right of mortgage shall be transferred to what is deposited.

Section (1418) The provisions relating to possessive mortgage of a movable property shall apply to the mortgage of the debt to the extent not repugnant to the preceding provisions.

b. The Commercial code provides the following articles:

Article (60): the commercial mortgage, which is subject to the following rules, guarantees the commercial debt.

Article (61/2): Bonds are mortgaged by transfer as guarantee to be documented in the records of the issuer and on the bond.

Article (61/3): payment order shall be mortgaged by endorsement stating (value held for guarantee) or other words that give a similar meaning.

Article (61/4): regular debts due for a specific person are mortgaged, in all circumstances, by a written deed with a fixed date notified to the debtor.

Conclusion:

1. The Jordanian legislation provides the following:
 - a. The security mortgage
 - b. The possessive mortgage.
 - c. The possessive mortgage includes mortgage of immovable property, mortgage of movable property and mortgage of debt.
 - d. Mortgage of debt includes regular debt, bonds and payment orders.
 - e. Commercial mortgage includes regular debt, bonds and payment orders.

Section Three: Documentation of the Mortgages

Unlike trading in and mortgaging of bonds where the rules for documenting the transactions are clearly stated, neither the companies law nor the securities Law include rules on documenting the Mortgages guaranteeing the bonds. The companies law in article (122) provides that the said properties and assets must be held as a security for the loan in accordance with the legislations in force. The securities Law also in article (6) provided that the regulations, instructions and decisions issued by the JSC shall apply to securities traded in the market with respect to several aspects including the transfer of ownership rights and the rights arising from such transfer. The rights arising from such transfer include transfer of the rights in the guarantees securing the bonds. Until this moment there are no such regulations or instructions in force to cover these issues.

In such a case, this gap needs to be bridged by applying the transfer and documentation rules and provisions of other laws relating to the subject matter such as civil code and commercial code. For the purpose of this report the focus will be given to the security mortgage and the commercial mortgage as follows:

a. The Civil code provides the following documentation requirement for security mortgage:

Section (1323): The security mortgage shall not be valid except by its registration and the mortgagor shall be liable for the contract expenses unless it is otherwise agreed.

Section (1341): The mortgagee of security mortgage may, subject to the debtor's approval, waive his right to another and the waiver deed shall be registered in the Land Registry Department.

Section (1347): The subrogation or transfer of the security mortgage or the assignment of its priority shall not be effective against the non-contracting parties except by its entry in the deed of the original right and its registration.

b. The law of holding immovable properties as security for debt provides the following documentation requirement for security mortgage:

Article (5): requires creditor "bond holder" to sign the report and the creditor approval on the mortgage deed.

Article (6): the deed shall be organized at the directory of land registrar.

Article (10) the mortgagee may transfer his right to another person and the transfer deed shall be registered in the Land Registry Department.

c. The Instructions on Mortgage, its transfer and dismortgage of 2001 provides the following documentation requirements for transfer of security mortgage:

Article (4): the transfer deed shall be organized in the Land Registry Department, without debtor approval in case if the mortgage deed is transferable to order.

d. On the other hand the civil code provides the following documentation for requirements for possessive mortgage:

Section (1375): In order that the possessive mortgage of property be completed and be obligatory it shall be received by the creditor or a competent person and the mortgagor may revoke the mortgage before delivery.

Section (1405): The possessive mortgage of movable property shall not be effective against others unless it is recorded in a document with a fixed date in which the debt and the mortgaged property together with the transfer of possession to the mortgagee are specified.

Section (1408): The preceding provisions shall be applicable to the extent they are not repugnant to the commercial and specials laws.

Section (1409): Whoever mortgages a debt owed to him shall deliver the deed proving the debt to the mortgagee

Section (1410):

1. The mortgage of a debt shall not be effective against the debtor or others unless this mortgage is officially notified¹ to the debtor or he accepts it.
2. And it shall not be effective against others except by the possession of the deed of the mortgagee, and the priority of the debt shall be calculated from the proved date of notification or acceptance.

Section (1411): Bonds and payment orders shall be mortgaged in the special manner provided for in the law for their subrogation provided that it shall be stated that the subrogation is made by way of mortgage.

Section (1418): The provisions relating to possessive mortgage of a movable property shall apply to the mortgage of the debt to the extent not repugnant to the preceding provisions.

e. Commercial law provides the following documentation requirement for commercial mortgage:

Article (61/2): Bonds are mortgaged by a mortgage deed registered at the records of the issuer and on the bond

¹ Notified by notarial notice served through the Public Notary serving in a Court of law

Article (61/3): Payment orders are mortgaged by an endorsement stating (value held for guarantee) or other words that give a similar meaning.

Article (61/4): Regular debts due for a specific person are mortgaged, in all circumstances, by a written deed with a fixed date, and the debtor should be notified.

f. Companies Law provides the following documentation requirement for mortgage of bonds:

Article (71):

- a) The Limited Liability Company shall keep at its headquarters a special register for the shareholders in which the following information pertaining to them shall be recorded. The Company manager or its Management Committee shall be responsible for this register and for the accuracy of the information listed therein:
- 4) Attachments, mortgages or any other liens and the details that may occur to a shareholders share(s).

Article (83): Repeated

A- The private shareholding company shall keep at its head office a special register for the shareholders in which the following information pertaining thereto shall be recorded. The company's Board of Directors shall be responsible for this register and for the correctness of the information listed therein: 4) Attachments, mortgages or any other liens imposed on the shares of the shareholder and the details related thereto.

F- No mortgage or attachment may be effective against the company, the other shareholders, and others unless the mortgage or attachment is recorded in the company's register with the Controller. In case of imposing a mortgage, the mortgaged or attached share may not be transferred without the approval of the mortgagor or the party that has imposed the attachment mortgage.

G- If the company's shares are listed in any stock exchange, the provisions governing the functions of the stock exchange shall supersede the provisions of this Article.

Article (98):

- a) The Public Shareholding Company shall keep one or more register wherein shall be recorded the names of shareholders, the numbers of shares held by each one of them, and any conversion procedures affecting same and other information relating thereto and to the shareholders.

g. The Law of the Notary Public No. 11 of 1952 and its amendments provides the following documentation requirement for mortgage of bonds:

Article 25 Taking into consideration what is stated in any other law the Notary Public: 2) organize and document contracts and deeds relating to disposal of movable property such as sale, purchase, transfer, rent, mortgage and other deeds.

Conclusion:

1. The security mortgage is documented and valid only by its registration. The land registry department is in charge of registering the mortgage deed with the presence of the mortgagor and the mortgagee.
2. The possessive mortgage of movable property shall not be effective against others unless it is recorded in a document with a fixed date in which the debt and the mortgaged property together with the transfer of possession to the mortgagee are specified.
3. Transfer of mortgage right shall be documented and registered
4. Bonds are mortgaged by being recorded in the issuing company's register.

Section Four: Fluctuation of Mortgaged Assets

The fluctuation of mortgaged assets is dealt with in the civil code particularly in the following articles:

Section (1328): The property under security mortgage must be existent at the time of making the mortgage.

Section (1329):

1. Security mortgage shall not be applied except to an immovable property, which is capable of disposition or a right in rem in immovable property.
2. And the Court may annul the security mortgage contract if the mortgaged immovable property is not therein sufficiently defined.

Article (1373): of the Civil Code states that the mortgagor of an immovable property under security mortgage shall be liable for it and fully responsible for its safety up to the date of satisfaction of the debt and the mortgagee shall be entitled to object to every deficiency in his security and take the measures which preserve his right provided that he may have recourse against the mortgagor for the expenses.

Article (1405): The possessive mortgage of movable property shall not be effective against others unless it is recorded in a document with a fixed date in which the debt and the mortgaged property together with the transfer of possession to the mortgagee are specified.

Article (1406): if the mortgaged property is threatened with demolition or deficiency in value the mortgagee shall notify the mortgagor thereof, and if the mortgagor shall not provide to the mortgagee another security either of them may apply to the Court to sell the mortgaged property and thereupon the creditor's right shall be transferred to the price.

Section Five: Bonds Owner’s Assembly and Issue Trustee

The Companies Law, by operation of law, creates what is called Corporate Bonds Owners Assembly (hereinafter referred to as the “Assembly”). The Assembly may appoint an Issue Trustee (hereinafter referred to as the “Trustee”). The right of the Assembly and the Trustee are stated in the Companies law. The following are the relevant articles.

Article (2/b): The words and expressions, “Commission”, “Stock Market”, “Market”, “Depository Center”, “Coverage Promissory”, “Issue Manager” and “Issue Trustee”, wherever stated in this Law, shall have the definitions ascribed to it pursuant to the Securities Law in force.

Article (116): Corporate bonds are negotiable securities that may be issued by Public or Private Shareholding Companies or any company permitted by the Securities Law to issue such bonds. Corporate bonds can be offered for subscription in accordance with the provisions of this Law and Securities Law in order to obtain a loan. The Company undertakes to repay the loan principal and interests in accordance with the issue conditions.

Article (118):

- i. Corporate bonds shall be registered in the names of their owners. The selling of same shall be documented in the issuing Company registers or with the authority which keeps such registers. These corporate bonds are negotiable in the markets as stipulated in the Securities Law in force.
- b. In the cases approved by the Controller and the Securities Commission it is permissible to issue corporate bonds to holder in accordance with the instructions issued by the Commission for this purpose.

Article (126):

- i. An assembly named Corporate Bonds Owners Assembly will be formed from the owners of corporate bonds in every issuance by operation of law.
- ii. The Corporate Bonds Owners Assembly shall have the right to appoint an Issue Trustee at the expense of the Company issuing the corporate bonds.
- iii. The issue trustee shall be licensed by the concerned authorities to practice this activity.

Article (127): Duties of the Corporate Bonds Owners Assembly

- a) Corporate Bond Owners Assembly shall be responsible for safeguarding the rights of the bond owners and for taking the necessary measures to preserve these rights, in cooperation with the issue trustee.

- b) The Corporate Bonds Owners Assembly shall convene for the first time upon the invitation of the Board of Directors of the Company issuing the corporate bonds. The appointed issue trustee shall be responsible for inviting the Assembly for subsequent meetings.

Article (128): The issue trustee shall assume the following authorities:

- a) To represent the Corporate Bonds Owners Assembly before Courts as a plaintiff or a defendant and to represent same before any other authority.
- b) To undertake the secretarial duties at the meetings of the Corporate Bonds Owners Assembly.
- c) To perform the work necessary for protecting the corporate bond owners and safeguarding their rights.
- d) Any other duties entrusted to him by the Corporate Bonds Owners Assembly.

Article (129): The borrowing company shall invite the issue trustee to the meetings of the Company General Assembly. The issue trustee shall attend such meetings and express his opinion thereat, without having the right to vote on the decisions of the General Assembly.

Article (130):

- a) The issue trustee shall invite the corporate bond owners to meet whenever he deems it necessary, provided that the Corporate Bonds Owners Assembly meet at least once a year.
- b) The Corporate Bonds Owners Assembly shall be invited in accordance with the rules applied to the invitation to the ordinary meetings of the General Assembly. Invitations and meetings of the Corporate Bonds Owners Assembly shall be subject to the same provisions, which govern the invitations and meetings of the General Assembly.
- c) Any action violating of the corporate bonds prospectus shall be considered null unless approved by the Corporate Bonds Owners Assembly by a three-quarter majority of votes represented in the meeting, provided that the corporate bonds represented in the meeting are not less than two-thirds of the value of the issued bonds which have been subscribed for.
- d) The issue trustee must notify the Controller, the issuing Company and any securities market on which the bonds are listed of the decisions adopted by the Corporate Bonds Owners Assembly.

Conclusion:

1. Corporate Bonds Owners Assembly will be formed from the owners of corporate bonds in every issuance by operation of law.

2. The Assembly shall have the right to appoint an Issue Trustee. The Issue Trustee shall have the definition ascribed to it pursuant to the Securities Law
3. The Issue Trustee shall be licensed by the concerned authorities to practice this activity.
4. The Assembly shall be responsible for safeguarding the rights of the bond owners and for taking the necessary measures to preserve these rights, in cooperation with the issue trustee.
5. The Issue Trustee shall assume several authorities including representing the Assembly before courts.

Section Six: Legal issues:

1. In this context the issue being raised is that whether trading in guaranteed bonds is legally enforceable. The law of holding immovable properties as security for debt in article (6) required that the land registry department organize mortgage deeds. Such deed is in favor of all the creditors and under their names. Such requirement will have all the bondholders' presence in the land registry department and in the companies' registry. Such requirement is impractical although presence of bondholders could be done by their agents. Therefore, documentation of security mortgage and mortgage of bonds require registration of mortgage by the mortgagee and mortgagor.
2. The creditor's right shall be clearly specified in the mortgage deed in order to be able to transfer it. Lack of such specification will create negative legal implications.
3. Article (10) of the same law requires the mortgagor and the mortgagee to document the transfer with the Land Registry Department. Such requirement frustrates the concept of negotiability of a bond in the market.
4. The fluctuation of assets held as security for the bonds is dealt with in the civil code. The civil code and commercial code require that the asset subject to the mortgage needs to be sufficiently defined and must be existent at the time of making the mortgage. Notwithstanding these requirements, the fluctuation of the assets after being mortgaged shall not constitute a legal obstacle as discussed in section seven.
5. Regarding the Assembly and the Trustee, by reviewing the related articles one could argue that it is not clear if the Assembly has any juridical personality whereby the Assembly can act on behalf of the bondholders and acquire rights such as a mortgage. It is not mandatory to appoint the Trustee, which raises the scenario where no Trustee is appointed who will act on behalf of the Assembly. Another gap is that the Trustee is not defined in the Securities Law and there are no licensing instructions in force. The articles in the statute that bestow the authorities upon the Trustee do not include clear wording on whatever the Trustee can acquire the mortgage or represent the Assembly as a trustee. All these issues attribute a further complication to the subject matter where it could have been easily avoided. The Trustee could assume his responsibilities had the law indicated them clearly or had it been defined under the securities law or the instructions.

Section Seven: Discussion:

Based on the abovementioned, it is apparent that registering the mortgage under the names of the bondholders combined with the requirement to specify the creditor right in the mortgage form the core of the problem under this subject. Such rules require the appearance of all bondholders before registrar and forbade transferring mortgages to new creditors upon negotiation. Alternatively, the registration of the mortgage in favor of a special purpose vehicle that has an independent nature from the bondholders will avoid these obstacles.

The legal vehicle to achieve that would be amending the companies law or the issuance of new law. If the step of amending the companies law shall be taken, a provision on the juridical personality of the Assembly should be clearly indicated. Conferring additional authorities to the Assembly must, as well, be indicated clearly such as the right to acquire a mortgage. Alternatively, such a right could be part of the Trustee's powers and authorities.

It could also be needed to create new procedures for collateralization of assets that attribute the authority of the registrar to the JSC and to maintain a record to document the mortgages. The best way to achieve that will be through a new law or an amendment to the securities law provided that such an amendment be more thoroughly examined to ensure it does not contradict existing laws or rules.

Had article (6) of the securities law provided a clear statement about the mortgage, and then a regulation issued by the JSC on this regard would have been sufficient. But absence of such manifestation in article (6) will impede the legal validity of any such regulation if it contravenes with the mortgage laws, since clearly the law prevails over the regulations in case of contradiction.

Other option is issuing a new law for regulating bonds including the documentation of guarantees offered to secure bonds. Such law should handle all the issues related to the organization of the mortgage deed, transferability of the mortgage, appointment of the agent and his right to acquire mortgages on behalf of the bondholders, waiver of the debtor's approval and the sufficiency of registering the sale of the secured bond at the debtor's records or other competent authority.

On the other hand to avoid the debtor's approval requirement, the mortgage law drops this requirement when it relates to a mortgage deed to order, which is commonly used in Jordan. In all other cases cancellation of such requirement could be achieved by amendments similar to the ones suggested above.

The civil code provides specific rules dealing with the fluctuation of the value of the assets mortgaged, specifically articles (1338) and (1406). Under these articles the mortgagee shall be entitled the right to apply for the immediate satisfaction of his debt or the provision of sufficient security for it, if due to the fault of the mortgagor, the immovable property under security mortgage shall be demolished or become deficient. If the demolition or deficiency shall be for a cause not due to the mortgagor he shall have the option of providing sufficient security for the debt or satisfying the

debt before it is mature. Article (1406) provides that if the mortgaged movable property is threatened with demolition or deficiency in value, the mortgagee shall notify the mortgagor thereof, and if the mortgagor shall not provide to the mortgagee another security, either of them may apply to the Court to sell the mortgaged property and thereupon the creditor's right shall be transferred to the price.

Section Eight: Recommendation:

Based on the above mentioned and taking in to consideration the nature of the issues that were discussed, we recommend amending the companies law and include special rules to allow registering the mortgage in favor of the Assembly or the Trustee. Additional amendments could be recommended that touch upon the topic of providing clearer authorities to the Assembly or the Trustee.

We also recommend giving article (6) of the Securities law more teeth by issuing regulations that would set into motion the topics included in that article.

Moreover, it is recommended to issue instructions detailing the licensing requirements of the Trustee pursuant to article (126/ 2) of the Companies law.

A further recommendation has to deal with giving a definition of the Issue Trustee pursuant to article (2) of the companies law. Although this article directs us to the securities law, however, and after reviewing the securities law, we can see that it fails to provide any mention of the Issue Trustee.